BEFORE THE FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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| In the Matter of | ) | |
| | ) | |
| Developing a Unified Intercarrier | ) | CC Docket No. 01-92 |
| Compensation Regime | ) | |

OPENING COMMENTS OF THE
COLORADO TELECOMMUNICATIONS ASSOCIATION,
OREGON TELECOMMUNICATIONS ASSOCIATION
AND WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION

MAY 23, 2005

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## SUMMARY

The Opening Comments of the Rural Associations[1] stress the need for the Commission to take particular care in evaluating the plans before the Commission on the subject of a unified intercarrier compensation mechanism. The Rural Associations advocate a balanced approach of reasonable carrier charges, reasonable end-user charges and a reasonably sized federal universal service fund.

The Rural Associations support the principles advocated by the Rural Alliance. In the Opening Comments, the point is made that many of the principles of the Rural Alliance match the principles advocated by NARUC. While NARUC's principles are an evolving set of principles, it is expected those principles will move closer to those advocated by the Rural Alliance, rather than further away.

One of the most important principles advocated by NARUC is that any plan that is considered by the Commission for adoption must be evaluated on a carrier-by-carrier basis, by state, to determine what the results will be, not just for intercarrier charges, but also end-user charges and the size of the universal service fund. To assist in that effort, the Rural Associations have identified the amount of transition that would be needed out of intrastate access charges to reach a unified rate and to an end-user, monthly Subscriber Line Charge (SLC) on a company-by-company basis, for rural companies, for each of the states involved in these Opening Comments. The result produces a monthly per line amount of as high as $60.00. There are many rural telephone companies that would face imposing end-user SLCs, just for the intrastate piece, excluding any interstate transition, of $10.00 per month, per line or more. Imposition of end-user charges of this magnitude clearly places a plan in violation of the principles enunciated

[1] The term "Rural Associations" is defined below.

by Congress in 47 U.S.C. §254(b) where rural rates must be comparable to urban rates.

For any intercarrier compensation plan to be viable, it must produce reasonable end-user charges and must not force so much of the cost recovery into universal service funds as to make those funds no longer viable. The end result should be that investment is encouraged, not discouraged, in telecommunications infrastructure in Rural America.

# I. INTRODUCTION

In this docket, the Federal Communications Commission is undertaking its most important inquiry for the future of telecommunications services in rural America. This statement is not bombast or hyperbole. It is a statement of fact. What the FCC does in this docket will shape the future of telecommunications in rural America for many years to come. Decisions made in this docket will either preserve vital telecommunications infrastructure in rural America or precipitate a crisis. It is for these reasons that the Colorado Telecommunications Association, the Oregon Telecommunications Association and the Washington Independent Telephone Association have undertaken to submit these joint comments (Opening Comments). For ease of reference, the three state associations will be referred to in the Opening Comments as the Rural Associations.

The rural telephone companies[2] that are members of the three associations supporting these Opening Comments are as follows:

<u>Colorado Telecommunications Association</u>

Agate Mutual Telephone Co-op Association
Big Sandy Telecom, Inc.
Blanca Telephone Company
Columbine Telecom Company
Delta County Tele-Comm, Inc.
Dubois Telephone Exchange, Inc.
Eastern Slope Rural Telephone Association, Inc.
Farmers Telephone Company, Inc.
Great Plains Communications, Inc.
Haxtun Telephone Company
Nucla-Naturita Telephone Company
Nunn Telephone Company
Peetz Cooperative Telephone Company
PC Telecom
Pine Drive Telephone Company
Plains Cooperative Telephone Association, Inc.
Rico Telephone Company

[2] As that term is used in 47 U.S.C. §153(37).

Roggen Telephone Company
Rye Telephone Company
South Park Telephone Company
Stoneham Cooperative Telephone Corp.
Strasburg Telephone Company
Sunflower Telephone Company
Union Telephone Company
Wiggins Telephone Association
Willard Telephone Company

Oregon Telecommunications Association[3]

Asotin Telephone Company
Beaver Creek Cooperative Telephone Company
Canby Telephone Association
Cascade Utilities, Inc.
Colton Telephone Company
Eagle Telephone System, Inc.
Gervais Telephone Company
Helix Telephone Company
Home Telephone Company
Molalla Communications, Inc.
Monitor Cooperative Telephone Company
Monroe Telephone Company
Mt. Angel Telephone Company
Nehalem Telecommunications, Inc.
North-State Telephone Co.
Oregon-Idaho Utilities, Inc.
Oregon Telephone Corporation
People’s Telephone Co.
Pine Telephone System, Inc.
Pioneer Telephone Cooperative
Roome Telecommunications Inc.
St. Paul Cooperative Telephone Association
Scio Mutual Telephone Association
Stayton Cooperative Telephone Company
Trans-Cascades Telephone Company

[3] Verizon Northwest Incorporated, SPRINT Northwest, Citizens Telecommunications of Oregon and Malheur Home Telephone, a Qwest Corporation affiliate, are members of the Oregon Telecommunications Association, but are not participating in these Comments.

Washington Independent Telephone Association

Asotin Telephone Company
Ellensburg Telephone Company
Hat Island Telephone Company
Hood Canal Telephone Co., Inc.
Inland Telephone Company
Kalama Telephone Company
Lewis River Telephone Company, Inc.
Mashell Telecom, Inc.
McDaniel Telephone Co.
Pend Oreille Telephone Company
Pioneer Telephone Company
St. John Co-operative Telephone and Telegraph Company
Tenino Telephone Company
The Toledo Telephone Co., Inc.
Western Wahkiakum County Telephone Company
Whidbey Telephone Company
YCOM Networks, Inc.

## II. ORGANIZATION AND FOCUS OF COMMENTS

These Opening Comments will begin with a review of the principles to be applied in analyzing the development of a unified intercarrier compensation regime. There are several principles that must be kept firmly in mind as this process goes forward.

The Opening Comments will then turn to the major issues raised in the Further Notice of Proposed Rulemaking (FNPRM).[4] In that regard, the Opening Comments will discuss the overall goals of cost standards; focusing on use of embedded costs by rural telephone companies. On the issue of cost recovery, the Opening Comments discuss the need to balance recovery from end-users, the universal service fund and carriers. The Opening Comments will address universal service and the need to maintain the size of the fund at a level that is politically sustainable. In addition, the Opening Comments will discuss issues regarding technological neutrality, particularly some aspects of the Commercial Mobile Radio Service (CMRS) and Voice Over Internet Protocol (VoIP) issues. Finally, some of the implementation issues will be discussed.

What these Opening Comments will not do is to comment in detail on several of the proposed plans have been submitted to the FCC. Instead, in the course of discussing the principles and major issues, the Opening Comments will comment on three plans. The first is the proposal of the Rural Alliance, combining aspects of the Expanded Portland Group (EPG) plan and the Alliance for Rational Intercarrier Compensation (ARIC) plan. The Opening Comments will also address certain aspects of the Intercarrier Compensation Forum (ICF) plan and National Association of Regulatory Utility Commissions (NARUC) "Straw Man" Proposal.

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[4] In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, FCC 05-33 (Rel. March 3, 2005).

## III. THE PRINCIPLES FOR THE DEVELOPMENT OF A UNIFIED INTERCARRIER COMPENSATION REGIME MUST BE FIRMLY ESTABLISHED

The FNPRM states that the goals for developing a unified intercarrier compensation regime should be to promote economic efficiency,[5] preserve universal service,[6] and be competitively and technologically neutral.[7] Another overarching goal should be to promote infrastructure development in rural America.

At the outset, the Rural Associations note that **all** bill and keep plans fail to meet these major objectives. As will be developed later in these Opening Comments, a bill and keep plan does not promote economic efficiency if such a plan allows use of a rural network without compensation. Further, a bill and keep plan does not preserve universal service to the extent it again allows the use of a rural network by other carriers without compensation and requires end-users to pay a disproportionate share of the costs of the rural telecommunications network. Nor is a bill and keep plan competitively and technologically neutral if Internet Protocol (IP) providers are given free use of the public switched telecommunications network (PSTN) and wireless carriers are granted large local calling areas by FCC fiat. The only type of plan for a unified intercarrier compensation regime that can meet all of the major objectives is one that has a balance of: (1) reasonable carrier charges for use of the rural telephone company's network; (2) reasonable end-user charges that conform to the direction in 47 U.S.C. §254(b) that rates for services in rural areas be comparable to rates in urban areas for comparable services; and (3) a level of universal service fund (USF) support that is politically and socially sustainable.

Further, bill and keep does not conform to the requirements of §254(k) of the

[5] FNPRM at ¶31.
[6] FNPRM at ¶32.
[7] FNPRM at ¶33.

Telecommunications Act of 1996 (the Act). If interexchange carriers (IXCs) receive free use of local networks, the competitive costs associated with offering equal access and dialing parity for long distance service are forced to be recovered through a universal service mechanism. That subsequent growth in the size of the universal service fund places an undue pressure on the universal service fund.

These Opening Comments are not intended to dwell upon the negative. However, a bill and keep plan will certainly spell the potential, if not actual, downfall of many rural networks in this nation. If bill and keep is taken off the table as a viable means of providing service in rural America, a better focus on the principles needed to guide development of a unified intercarrier compensation regime can be developed. One such set of unifying principles is offered by the Rural Alliance.

A. <u>The Principles of the Rural Alliance Make Sense for Rural America</u>.

The principles enunciated by the Rural Alliance are as follows:[8]

- Cost-based Intercarrier Compensation Rates.
    - Rural carriers' rates should be based upon embedded cost. These rates should be unified over time.
- Current Interconnection Points Should Be Maintained.
    - The network interconnection points should be at the existing meet points and should be located within the rural local exchange company (LEC) network service area.
- Compensation Obligations – The Retail Service Provider Should Pay for the Network Usage it Creates.
- Transiting Services Should be Available at Just and Reasonable Rates and Conditions.
    - Transiting service provided by tandem owners retaining market power should be rate regulated.

[8] The principles are taken from the most recently available draft of the Comments of The Rural Alliance to be filed in this docket on May 23, 2005.

- There Should be a Local Service Benchmark for Universal Service Purposes.
- Revenue Repayment Payments Should be Based on Net Revenue Losses.
- Universal Service Funds Must be Sustainable.
    - Contributions to USF mechanisms should be derived from the broadest possible base of contributors, including VoIP and IP enabled services.
- Transition to the IP Environment.
    - Affordable and open access to IP backbone service is necessary to ensure universal connectivity for rural customers.

These principles make sense for rural America. The principles are based upon the realities of financing, building and maintaining efficient networks to serve rural America. The Rural Alliance is not the only one thinking in these terms. The principles of the Rural Alliance juxtapose rather neatly with many of the principles set forth by NARUC.[9]

B. Comments on the NARUC Principles.

NARUC has eight major categories of principles. These include: Applicability; Economic Soundness; Competitive Intercarrier Market Principles; Non-Competitive Intercarrier Market Principles; Federalism; Universal Service and Consumer Protection; Achievability and Durability; and Prerequisites for Plan Implementation.[10] In each of these areas, NARUC designated one or more principles. Those principles and the Rural Associations' comments on those principles follow.

[9] The Rural Associations acknowledge that there are some differences between the Rural Alliance and NARUC's implementation of those principles, but are confident that NARUC's position will evolve to fit even more closely with the Rural Alliance.

[10] The principles come from NARUC's Notice of Written Ex Parte Presentation dated March 1, 2005. The Rural Associations recognize that NARUC's position is evolving and not every thought contained in the March 1, 2005 ex parte presentation may survive. However, due to timing considerations, that is the set of principles issued by NARUC that are addressed in these Opening Comments. Apparently, NARUC filed another ex parte presentation on May 18, 2005. That presentation is filed too late to be addressed here.

1. NARUC's Principles on Applicability:

NARUC Principle: An integrated intercarrier compensation plan should encompass rates for interconnecting CLEC and ILEC local traffic as well as access charges paid by interexchange carriers.

The Rural Associations agree with the principle that the rates for both local interconnection and access services should be addressed. However, this does not mean that the intercarrier compensation rate for local traffic should be the same as intercarrier compensation rate for access traffic. It may well be that the two will merge over time. However, these are two different markets. The first look should be at the access market. In other words, the first step in developing a unified intercarrier compensation regime is to transition intrastate and interstate access rates to a unified rate. Given the potential for large shifts in revenues when intrastate and interstate access are merged over time,[11] great care in planning the transition is needed.

The reason that a new intercarrier compensation plan should consider both local traffic and interexchange traffic is the potential for a market arbitrage. This issue is discussed in more detail below.[12] What happens under market arbitrage is that a carrier identifies or routes traffic for delivery as if it were traffic for the lower priced market when it should be rated at a higher price. For example, there is some evidence that today interexchange carriers overstate the Percent Interstate Usage (PIU) to take advantage of generally lower interstate access rates.[13] On a forward-looking basis, such market arbitrage may occur between local (which for this purpose includes extended area service) and interexchange markets. For most rural companies, traffic from competitive local exchange companies (CLECs) and most interexchange carriers are

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[11] See, discussion at Section V.2, below.
[12] See, discussion of "Phantom Traffic" at Section III.B.4.
[13] During a period of transition to a unified access rate for interstate and intrastate interexchange traffic, rural companies should have the tools to address PIU arbitrage. One such tool is requiring interexchange carriers to provide verifiable support for the PIU reported for use in a rural telephone company's exchange. Absent such verifiable support, the PIU should be required to be set at a default of fifty percent.

delivered through RBOC tandems. Rural companies have found that the role of the RBOC transiting carrier in delivering traffic to rural markets should be carefully examined so that such transiting carrier does not employ practices that encourage arbitrage or deliver "Phantom Traffic," described at Section III.B.4, below.

NARUC Principle: CLECs, IXCs, ISPs, VoIP, wireless, and any other companies exchanging traffic over the Public Switched Telecommunications Network should be covered ("Covered Entities").

This principle needs to be clearly established. Providers using a particular technology should not be given an undue advantage over other carriers. In this industry there really is no longer such thing as a fledgling or nascent technology. Given the rapidity with which RBOCs and others have adopted VoIP technologies, any artificial break in pricing is only a misguided attempt at controlling markets.

The principle cannot be stated too boldly: ANY CARRIER USING THE PUBLIC SWITCH TELECOMMUNICATIONS NETWORK MUST PAY ITS APPROPRIATE SHARE OF THE COST OF THAT NETWORK. The carriers using the rural telecommunications network or relying on the rural network to serve customers should pay a portion of the cost of that network. For example, VoIP providers that use the PSTN to originate or terminate calls should pay for their use of the PSTN.

NARUC Principle: No Covered Entity should be entitled to purchase a service or function at local rates as a substitute for paying intercarrier compensation.

The Rural Associations agree with this principle. Market arbitrage should not be allowed.

2. <u>NARUC's Principles on Economic Soundness</u>:

NARUC Principle: The compensation plan should minimize arbitrage opportunities and be resistant to gaming.

Agreed. The key in this area is the structure for minimizing arbitrage opportunities. The Rural Associations also note that a bill and keep system provides an opportunity for gaming. Under bill and keep, interexchange carriers could find ways to market products that rely on a "no cost" use of a rural telephone company's network to originate traffic. The widespread "free" use of the rural telecommunications network is detrimental to the sustainability of the rural network.

For many rural telephone companies, their network exists primarily for the origination of calls to and termination of calls from areas beyond the local calling area. As a general rule, the rural telephone companies face little local competition from other facility-based wireline providers.[14] Even where there is entry by a facilities-based carrier, it is only in the most dense portions of the rural service area. It does not occur in the least dense portions of the rural service areas since the economies of scale do not justify entry by another facility-based wireline carrier. However, rural telephone companies do face increasing competition from VoIP providers, particularly those trying to use the originating network on a bill and keep basis. For example, in the state of Washington, one such "IP-in-the-middle" provider managed to make effective use of the rural companies' network to originate interexchange calls on a "bill and keep" basis, bypassing significant access charges that would and should have applied to its operations.[15]

NARUC Principle: Intercarrier compensation should be designed to recover an appropriate portion of the requested carrier's applicable network costs. At a minimum, this will require compliance with the jurisdictional separations and cost allocation rules, applicable case law in effect at any point in time, and 47 U.S.C. §254(k).

Agreed. While jurisdictional lines have blurred, it is still appropriate to align costs along

[14] This situation is changing where cable companies have service. In these areas, cable modem and sometimes phone service are offered as incremental service to the cable TV investment. However, this entry into the telecommunications market occurs only where sufficient density exists to justify a business case for deployment of cable TV services: the most dense portion of rural service areas.

[15] In the Matter of Washington Exchange Carrier Association, et al. v. LocalDial Corporation, Docket No. UT-031472, Final Order Granting Motions for Summary Determination, Order No. 08 (June 11, 2004).

jurisdictional separations and cost allocation rules.

NARUC Principle: A carrier that provides a particular service or function should charge the same amount to all Covered Entities to whom the service or function is being provided. Charges should not discriminate among carriers based on:

1. the classification of the requesting carrier;
2. the classification of the requesting carrier's customers;
3. the location of the requesting carrier's customer;
4. the geographic location of any of the end-users who are parties to the communication; or,
5. the architecture or protocols of the requested carrier's network or equipment.

What is important about this principle is that it recognizes that requiring all users of a network, not just end-user subscribers, to pay for the use of the PSTN efficiently allocates resources invested in the network. However, this is one of the more difficult principles to accomplish. To achieve this principle will require a period of transition. Interim rules should focus on the ways in which arbitrage may be prevented. The arbitrage issue is discussed in more detail later in these Opening Comments.

NARUC Principle: Intercarrier compensation charges should be competitively and technologically neutral and reflect underlying economic cost.

The Rural Associations agree that intercarrier compensation charges should reflect cost. The issue here is what is meant by "economic" cost. If NARUC has in mind Forward-Looking Economic Cost (FLEC), then this is an area where the Rural Associations disagree with NARUC. This is because no Forward-Looking Economic Cost or FLEC has been found to have general applicability for rural telephone companies.[16] The Rural Task Force's exhaustive analysis came to this same finding.[17] The Rural Task Force found:

[16] The only use of FLEC with rural companies that the Rural Associations are aware of is some very limited use in arbitrations setting company specific reciprocal compensation rates. It is an overly expensive process to apply FLEC on a company-by-company basis. The FLEC cost models do not work on an industry-wide basis.
[17] In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service (Rel. September 29, 2000) ("RTF Recommendation") beginning at p. 17.

> …when viewed on an individual rural wire center or individual Rural Carrier basis, the cost generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. As a result, it is the opinion of the Task Force that the current model is not an appropriate tool for determining the forward-looking cost of Rural Carriers.[18]

The FCC accepted the Rural Task Force's Recommendation, stating:

> We find that continuing to base support for rural carriers on embedded costs for the next five years is a reasonable and prudent approach to take in light of the record before us. The present record fails to provide the analysis necessary to permit a transition of rural carriers to forward-looking high-cost support mechanism. Before we could transition to such a mechanism, it would need to be fully analyzed and considered.[19]

Nothing has changed since that order.

The Rural Associations have found no indication that work on economic cost model since the time of the Rural Task Force's recommendation has produced any significant improvement in those models. The models just do not function well at the density levels served by a rural telephone company. The only reliable and accurate cost methodology that has ever been successfully applied to rural telephone companies are each company's own embedded costs.

NARUC Principle: The intercarrier compensation system should encourage competition by ensuring that requested carriers have an economic incentive to interconnect, to carry the traffic, and to provide high-quality service to requesting carriers. In limited circumstances, carriers may voluntarily enter into a bill and keep arrangement.

This principle can only be achieved where the environment is other than bill and keep. The only incentive that the rural telephone companies have to interconnect and carry the traffic and provide high-quality service to requesting carriers is when those requesting carriers pay their appropriate share of the cost of the network built by the rural telephone companies. As will be developed in further comments, it is simply impossible to recover a rural telephone company's

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[18] Ibid at p. 18.

[19] In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, And Further Notice of Proposed Rulemaking, FCC 01-157 (Rel. May 23, 2001) ("Joint Board Order") at ¶23.

network costs from its end-users and still have reasonable rates in rural areas. It is also impossible to expect that universal service funds can make up the difference, given the increasing political pressure on the universal service funds at today's contribution levels.

NARUC Principle: Volume of use should be considered when setting intercarrier compensation rates. Available capacity may be used as a surrogate for volume of use.

In some situations, this principle has applicability. However, particular care has to be used for rural telephone companies where capacity has to be put in place in increments that may not justify the same rate that the same capacity installation would generate in non-rural telephone company areas. For example, installation of a new DS-1 for transport has a much higher per customer cost when a rural company serves 500 customers in its only wire center compared to the same installation by a non-rural company serving, for example, fifty thousand customers in a single wire center and three million customers in that same state. This same type of variation also exists among rural telephone companies: a "one size fits all" capacity charge does not work as an industry-wide standard.

NARUC Principle: Any intercarrier compensation system should be simple and inexpensive to administer.

Absolutely. However, this does not mean that bill and keep is the answer. Bill and keep is not a simple or inexpensive intercarrier compensation system to administer. Bill and keep will force a change in service level and attitudes towards investment that is frightening to comprehend. While one might say that by multiplying any capacity or volume number times zero under a bill and keep approach makes it easy to produce a result, that superficial response ignores the reality of investment decisions and the cost of the modification of existing systems that are already in place. From a pragmatic standpoint, the most simple and inexpensive system to administer is the existing system. No changes are needed to billing systems, accounting systems, etc. To be practical, it should be recognized that some change will be needed. However, a close eye should be kept on minimizing the cost and complexity of any change.[20]

3. NARUC's Principles on Competitive Intercarrier Markets:

NARUC Principle: Market-based rates should be used where the market is determined to be competitive. A rigorous definition of "competitive market" is needed in order to prevent abuses.

No comment at this time.[21]

4. NARUC's Principles on Non-Competitive Intercarrier Markets:

NARUC Principle: An intercarrier compensation system should ensure that telecommunications providers have an opportunity to earn a reasonable return and that they maintain high-quality service. It should also encourage innovation and promote development of competitive markets.

The Rural Associations agree with this principle. The rural telephone companies have an outstanding track record of providing high-quality service. They can only do this under a system of intercarrier compensation that recognizes that all carriers that use the rural telephone company's network pay their appropriate share of the cost of that network. The densities and economies of scale in rural service areas do not allow for an environment in which the end-use customers pay for full cost of the entire rural network. In addition, political pressures created by the growing size of universal service funds means that the costs imposed by other carriers' use of a rural telephone company's network cannot be shifted to a USF mechanism with a wave of the hand. In Section V, below, the Opening Comments provide real-life examples of the size of the revenue shifts involved in this process, which are very large under some of the proposed plans. The primary emphasis of these Comments is the need for any plan the FCC might consider

[20] This is a principle that the ICF plan cannot meet on any level.
[21] The fact that the Rural Associations are making "no comment" on a particular subject should not be taken to mean anything other than that. There are only so many issues that can be addressed given the resources of the Rural Associations.

adopting must be measured on a company-by-company, state-by-state, basis to determine if the plan is feasible.

NARUC Principle: Government should limit the ability of carriers with market power to impose excessive charges.

The area where close examination should be undertaken is the transiting carrier's role in allowing arbitrage and the delivery of "Phantom Traffic."[22] For example, Qwest Corporation takes the position that as a transiting provider, it forwards for termination all traffic delivered to it at its tandems no matter what the origin. Qwest makes no effort to look at the originating end of the traffic and takes no responsibility for the traffic it delivers.[23] This results in substantial amounts of unbillable traffic delivered over Qwest's Feature Group C (FGC) network. It also results in what should be access traffic being delivered to Qwest's local/EAS[24] tandems and then delivered by Qwest over EAS trunks to a rural telephone company for call completion.

Rural telephone companies are beginning to develop the capacity to measure the extent to which Phantom Traffic is being delivered to their networks.[25] One such company is Beaver Creek Cooperative Telephone Company (BCT) in Oregon. BCT's measurements show that upwards of 52% of the traffic delivered to it by Qwest over FGC trunks fall into the Phantom Traffic category. BCT has also measured substantial amounts of traffic delivered to it over EAS trunks that on its face appears to be access traffic, not local or EAS traffic. What this demonstrates is the need for the transit provider to be more diligent in the routing of traffic it

[22] Phantom Traffic refers to the phenomenon of delivering traffic for termination for which no record of the responsible carrier who should be billed (other than the transiting carrier) is developed. One solution is to bill the transiting carrier for all of this traffic.
[23] Oral comments of Qwest Corporation in Washington Exchange Carrier Docket 02-01.
[24] EAS stands for extended area service. Under this service, customers in a "community of interest" are granted toll-free calling within the EAS area. What were once access revenue generating calls are now treated as local calls for intercarrier compensation.
[25] It is the rare exception to have installed the capacity to capture and record terminating traffic, rather than general practice.

receives or, in the alternative, bill the transiting carrier for all of the traffic delivered by the transiting carrier.

Most rural telephone companies are dependent upon an RBOC transit/tandem provider for the delivery of calls to and from the rural service area. This places the RBOC tandem/transit provider in the role of both a gatekeeper and a bottleneck. Without direct oversight, the transit/tandem provider can wield what is, in essence, monopoly power over the delivery of traffic to and from rural service areas. In today's environment, for the tandem provider to deliver all traffic without an accompanying record (unless paid for at uneconomically high levels) is equivalent to a taxi service delivering, for a fee, a burglar to someone's home and then saying to the homeowner, I will tell you who the burglar is for a fee. It just does not seem right.

There are at least three straightforward responses to Phantom Traffic. One is to absolutely require that all originating carriers properly populate the Carrier Identification Code (CIC) for wireline carriers and the Operator Company Number (OCN), for wireless carriers on all records. The transiting carrier would then have the obligation to deliver those records to the terminating company, without charge, for billing purposes. As an alternative, the originating carrier could be required to provide the data and if it fails to provide the necessary records, such traffic would be denied completion. The third resolution is to bill the transiting carrier for all traffic that falls within the "Phantom Traffic" category.

Another area where this is a concern is what appears to be a consolidating market for Internet backbone access. With the proposed merger of SBC and AT&T and the possible Verizon/MCI or Qwest/MCI merger, the available services for provision of Internet backbone will be consolidated. This is an area that deserves very close scrutiny, particularly with the evolution of

VoIP products.

NARUC Principle: Where charges are restricted by government action, carriers have the protections of due process, and confiscation is not permitted.

No comment at this time.

NARUC Principle: If any ILEC property or operations in the future could give rise to a confiscation claim, in a rate case or otherwise, then a practical way should be defined to exclude property and operations that are in competitive markets.

No comment at this time.

NARUC Principle: A proposal preserving a significant State role that fits within the confines of existing law is preferable.

There is certainly an appropriate role for the states, particularly in consumer protection and quality of service. A joint federal-state process to unify intercarrier compensation is preferable to a system imposed from above. Where universal service issues are involved a federal-state joint board is required.[26]

5. NARUC's Principles on Appropriate Federalism:

NARUC Principle: The reciprocal compensation system should ensure that revenues, cost assignment, and the risk of confiscation are jurisdictionally consistent for all classes of traffic.

There should be a collaborative effort between the FCC and the several state commissions developing a mutually beneficial system that recognizes the role of both the federal government and the states.

NARUC Principle: State commissions should continue to have a significant role in establishing rates and protecting and communicating with consumers.

The state commissions have a significant role to play in consumer protection and quality of service. This should be one of the major focuses for state commissions on a forward-looking basis.

[26] 47 U.S.C. §254(b).

NARUC Principle: To avoid creating harmful economic incentives to de-average toll rates by some interexchange carriers, the FCC should have the authority to pool costs within its defined jurisdiction whenever intercarrier compensation rates are high in some areas.

Pooling has provided major benefits for rural telephone company service areas. This issue is addressed in more detail below. Pooling at both the federal and state levels should continue to be available to rural telephone companies.

NARUC Principle: State commissions should retain a role in this process reflecting their unique insights, as well as substantial discretion in developing retail rates for services provided by providers of last resort, whether a dual or unified compensation solution is adopted.

The Rural Associations agree that there is an appropriate role for state commissions. That role should be directed primarily at consumer protection and quality of service. As noted above, states should retain the ability to allow pooling under some circumstances. Where pooling is appropriate, state commissions should have an oversight role.

NARUC Principle: A proposal preserving a significant State role that fits within the confines of existing law is preferable.

See above.

6. <u>NARUC's Principles on Universal Service and Consumer Protection</u>:

NARUC Principle: The transition to a new intercarrier compensation system should ensure continuity of existing services and prevent significant rate shock to end-users. Penetration rates for basic service should not be jeopardized.

This is a significant issue. Under the proposals put forth under a bill and keep or ICF type of approach, there will be significant rate shock to end-users. As will be described below, rates for basic service may move so high that penetration rates for basic service will be jeopardized.

From the viewpoint of the Rural Associations, underlying this NARUC principle are the standards already contained in the Act. These include the principles in §254(b) of the Act that:

- quality services should be available at just, reasonable and affordable rates;

- access to advanced telecommunications and information service should be provided in all regions of the nation;
- consumers in all regions of the Nation, including low-income consumers and those in rural, insular and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

Stated succinctly, this means that any universal service outcome of this docket must continue to encourage investment in rural areas, particularly in the capability of deploying broadband in rural areas.

NARUC Principle: A new intercarrier compensation system should recognize that areas served by some rural local exchange carriers are significantly more difficult to serve and have much higher costs than other areas.

This is a principle that should absolutely be etched in stone. It is the factual situation that the Rural Task Force recognized to be true. In the RTF Recommendation, the Rural Task Force found that rural telephone companies:

- have relatively high loop costs because of the lack of economies of scale and density;
- experience high difficulty and high cost in moving personnel, equipment and supplies to remote and insular communities;
- face geographic surface conditions, such as coral, volcanic rock and permafrost, that require expensive, specialized outside plant construction practices; and

- require more resources on a per customer basis, including duplicate facilities and backup equipment to protect network reliability.[27]

In addition, the Rural Task Force found that rural telephone companies:

- serve more sparsely populated areas;
- generally serve a customer base that includes fewer high-volume users, depriving those rural telephone companies of economies of scale;
- frequently have substantially fewer lines per switch than non-rural companies, providing fewer customers over which to spread high fixed network costs;
- have total investment in plant per loop at a level which is substantially higher for rural telephone companies than for non-rural telephone companies; and
- tend to experience plant specific and operation expenses which are substantially higher per customer than for non-rural telephone companies.[28]

The fact that areas served by many rural telephone companies are significantly more difficult to serve and have much higher costs than other areas has been recognized in intercarrier compensation mechanisms to date. To abandon this principle would mean the downfall of networks in many rural telephone company areas.

NARUC Principle: Rural customers should continue to have rates comparable to those paid by urban customers. End-user basic local exchange rates should not be increased above just, reasonable, and affordable levels.

This is a requirement under the Act and should be kept in the forefront of the FCC's deliberations.

NARUC Principle: Any intercarrier compensation plan should be designed to minimize the cost impact on both federal and State universal service support programs.

[27] RTF Recommendation at p. 12.

[28] RTF Recommendation at p. 11-13. See, also, Rural Task Force White Paper 2.

This is a practical reality. Political pressure on the rising levels of federal and state universal service support programs cannot be understated.

7. NARUC's Principles on Achievability and Durability:

NARUC Principle: A new intercarrier compensation system should not only recognize existing circumstances but should also anticipate changes at least over the intermediate term, and should provide solutions that are appropriately resilient in the face of change.

This is a challenging principle. It is a worthy aspirational goal. However, its accomplishment will be measured only by the passage of time.

8. NARUC's Principles on Prerequisites for Plan Implementation:

NARUC Principle: The estimated cost impact on a carrier-by carrier basis, by State, must be computed before a decision is made whether to adopt a new intercarrier compensation plan.

This is one of the most important of NARUC's principles. Given the critical importance of this docket, it is an absolute prerequisite that the estimated cost impact of a plan under consideration on a carrier-by-carrier basis, by state, must be computed before a decision is made. The Rural Associations recognize that this is a daunting task. The Rural Associations also recognize that some may interpret this as merely a delaying tactic. Undue delay should not be tolerated. However, given the importance of this docket, the decisions in the docket cannot be made in a factual vacuum.[29] It is critical that these calculations be undertaken; perhaps not to the last penny, but at least to the level that a strong sense of the outcome of any plan is understood.

NARUC Principle: The FCC should identify, quantify, and evaluate the total of all federal high cost universal service fund payments received by each company today. The federal universal service support mechanisms should be revisited as an intercarrier compensation plan is implemented to ensure that telecommunications services remain accessible and affordable to all Americans.

[29] There are, perhaps, delicate issues of confidentiality that need to be recognized in making these calculations.

The Rural Associations agree. Given the nature of the plans that have been proposed, there is a severe question as to whether the resulting federal high cost universal service fund is politically sustainable.

NARUC Principle: The FCC should be required to regularly revisit its cost allocation rules for regulated/nonregulated services. Costs that should not be recovered through regulated rates ought to be excluded from the computation of intercarrier compensation rates.

No comment at this time.

NARUC Principle: Before any new intercarrier compensation plan is implemented, the effect of the plan on local exchange rates, including both interstate and intrastate SLCs, should be computed.

The Rural Associations agree. To that end, calculations of the intrastate SLCs under certain scenarios has been undertaken. That information is included in the comments below.[30]

NARUC Principle: Even when a referral to a Joint Board is not mandated by law, in order to ensure State input the FCC should make a referral, and the Joint Board should act on that referral, in an expedited manner. Similarly, referrals to Joint Conferences should be handled on an expedited basis.

No additional comment at this time. Please refer to the earlier comments on state-federal interaction.

With these principles in mind, the Opening Comments will now address some of the major issues.

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[30] See Opening Comments at Section V, 2.

## IV. COST STANDARD

The FCC has asked a number of questions concerning the appropriate cost standard to be utilized in a unified intercarrier compensation regime.[31] The Rural Associations will review the economic arguments that may be presented in other comments and will defer discussion for now. However, the Rural Associations do have an observation.

The Rural Associations support developing cost based rates calculated based on each LEC's embedded costs. As noted earlier, as a matter of principle, the Rural Associations support the Rural Alliance's position that rates should be cost based using each carrier's embedded costs as the basis for the calculation, which accurately reflects the actual cost of the rural network. For rural telephone companies, this is the only cost standard that has ever been shown to work. The exhaustive work of the Rural Task Force demonstrated that the existing FLEC cost models are extremely poor predictors of the costs that are incurred in rural telephone company service areas. The Rural Task Force found:

- The [FLEC] model lines differed significantly from actual lines served. While the model generally tended to underestimate lines, in about one-third of the wire centers it overestimated lines.

- Comparisons of the number of route-miles of plant summarized in the model with actual data produced significant variations. Again, differences occurred on both the high and low ends with a general tendency for the model results to overestimate the actual data. In 12 percent of the wire centers studied, the model overestimated route miles by more than 200 percent.

- Model results for the type of plant varied widely from actual plant constructed. The model generally tended to overestimate the percentage of aerial and underground plant, and underestimated the percentage of buried plant. This was likely due to the diverse character of the rural geography, and the use of a single set of inputs by density zone that was based on the experience of non-Rural Carriers.

[31] See, e.g., FNPRM at ¶¶72, 73, 112-113.

- In calculating the applicable density zones, the model significantly underestimated wire center area. In 95 percent of wire centers the land area was understated, and in over one third of these the understatement exceeded 90 percent.

- The Synthesis Model significantly underestimated central office equipment (COE) Switching investment. This was likely due to the lack of economies of scale of the Rural Carriers, and the general tendency of the model to underestimate lines served.

- The Synthesis Model results for various elements of general support investment varied widely from actual data and from rational forward-looking assumptions, with almost as many cases of overestimation as underestimation.

- Network Operations and Customer Operations expenses were significantly underestimated. This was likely related to the lack of economies of scale of Rural Carriers.[32]

The Rural Task Force further found that because of the diversity among rural telephone companies, one model could not be used to estimate the costs for all rural telephone companies:

> …. We conclude that the non-rural method and Synthesis Model developed for the non-Rural Carriers are not the appropriate tool and application for Rural Carriers and will not produce a sufficient universal service mechanism for Rural Carriers that is in the public interest and consistent with the principles of the 1996 Act. The Task Force Recommendation relies on the Modified Embedded Cost Mechanism for Rural Carriers as a baseline to size the fund for Rural Carriers. This method is based on embedded costs of each ILEC's study area. In other words, support is based on the investments and expenses of each study area.[33]

This approach was adopted by the FCC, at least on an interim basis.[34] The FCC recognized that further work would have to be done on FLEC cost models before they could be used for rural telephone companies. However, time has passed and the models do not appear to have gained any appreciable improvement as they apply to rural telephone companies.

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[32] RTF Recommendation at p. 17-18. See, also, Rural Task Force White Paper 3.
[33] RTF Recommendation at p. 20. See, also, Rural Task Force White Paper 4.
[34] Joint Board Order at ¶24: "In particular, we find that adoption of the modified embedded cost mechanism is consistent with our obligations to ensure that the support provided to rural carriers over the next five years is specific, predictable, and sufficient." Also at ¶25: "The present record fails to provide the analysis necessary to permit a transition of rural carriers to a forward-looking high-cost support mechanism."

The reason for the lack of improvement is obvious if one thinks about the diversity between the telephone companies found by the Rural Task Force. Rural companies serve widely different areas. Their customer densities are generally fairly low, but can vary significantly: on a relative basis some rural companies serve more densely populated than others.[35] Rural company loop lengths are generally fairly long when compared to RBOCs; but, again, can vary on a relative basis among rural companies. The cost of installation of these loops varies widely among rural telephone companies. Some rural telephone companies may serve widely dispersed populations. Other rural telephone companies may serve a small rural population center with widely dispersed customers throughout the rest of the service area. There is no way that one model is going to be useful in covering this wide variety of rural telephone company service characteristics. What this means is that the process that has been used to date, focusing on embedded costs for rural telephone companies, is still the appropriate model.

As a further observation, the Rural Associations note that insofar as focusing on interstate access charges is concerned, the only cost based access rate that exists today are the existing interstate access rates currently embodied in the NECA tariffs. One approach might be to transition intrastate access rates to the interstate rates over a period of time of not less than five years. As will be seen below, rate shock issues must be considered. Any such transition should be the result of state and federal commission interaction. It should not be a case of federal preemption.

[35] However, the densities do not begin to rival the densities enjoyed by RBOCs.

## V. COST RECOVERY

1. General Comments.

The FNPRM asks a host of questions concerning cost recovery.[36] One aspect of the FCC's FNPRM is a statement that if someone advocates a target rate other than the $0.0095 adopted in the CALLS Order, such a variance from the CALLS target rate must be justified. The CALLS Order default rate of $0.0095 is a default rate that applies when a carrier elects the price-cap route. It is not a cost-based rate for rural telephone companies. Choosing to accept a particular default rate as part of a package is far different than having a rate arbitrarily imposed.

Further, the CALLS Order has never been shown as appropriate for rural companies. Without specific analysis of the costs associated with rural telecommunications networks, it is not appropriate to assign a default standard. On an anecdotal basis, several major wireless carriers have recently been willing to enter into traffic exchange agreements in the states of Washington and Oregon where the local termination rate is established at $0.02 in those negotiated agreements.[37] Why should a rate be artificially depressed to $0.0095, when the current marketplace shows an acceptable rate as $0.02?

The position of the Rural Associations is that cost recovery should include more than just end-users and universal service support. The carriers that use a rural telephone company's

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[36] See, e.g., FNPRM at ¶¶99-115.

[37] See, e.g., In the Matter of Clear Creek Mutual Telephone Company and T-Mobile USA, Inc. Negotiated Interconnection Agreement Submitted Pursuant to Section 252(e) of the Telecommunications Act of 1996, Public Utility Commission of Oregon Docket ARB 633, Order No. 04-710 (December 8, 2004); In the Matter of Scio Mutual Telephone Association and Sprint PCS Negotiated Interconnection Agreement Submitted Pursuant to Section 252(e) of the Telecommunications Act of 1996, Public Utility Commission of Oregon Docket ARB 631, Order No. 04-712 (December 8, 2004); In the Matter of the Request of Sprint Spectrum L.P. and M & L Enterprises For Approval of Negotiated Agreement Under the Telecommunications Act of 1996, Washington State Utilities and Transportation Commission Docket No. UT-053002, Order No. 01 (February 9, 2005); In the Matter of the Request of T-Mobile USA, Inc. and Whidbey Telephone Company For Approval of Negotiated Agreement Under the Telecommunications Act of 1996, Washington State Utilities and Transportation Commission Docket No. UT-053003, Order No. 01 (February 9, 2005). Literally dozens of these agreements have been filed and approved in the states of Oregon and Washington.

network should pay for that use. To some extent, the FNPRM appears directed towards squeezing access charges or any other charges to carriers using rural telephone company networks as low as possible. This has a very undesirable effect of forcing end-user rates to unreasonable levels or putting undue pressure on the universal service fund, or both.

2. State Specific Examples of Cost Recovery Issues.

On this issue of cost recovery, the Rural Associations believe that NARUC's principle that the effects of any plan, by carrier, by state, must be known in advance is an important principle. This Commission has also emphasized the need to fully analyze any new proposal. As stated in the Joint Board Order: "Before we consider transition to such a [forward-looking, high-cost] mechanism, it would need to be fully analyzed and considered."[38]

As one aspect of that effort, the Rural Associations have undertaken to price out the effect of moving intrastate access to a unified rate under three separate scenarios. The first scenario is bill and keep on origination, with the intrastate terminating access rates set at $0.01. The second scenario is moving intrastate access rates to $0.01 for both originating and terminating access. The third scenario would have the intrastate originating rates at $0.01 and the intrastate terminating rates at $0.02. Tables setting forth the additional monthly amounts per access line that would be needed to "unify" the intercarrier access rates are set out by state.[39] It must be emphasized that the numbers set forth on the following tables are per month amounts. It must also be emphasized that the per month amounts are for shifts of existing intrastate access revenues and, therefore, are in addition to increases in SLCs proposed under some plans, such as the ICF plan.

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[38] Joint Board Order at ¶25.

[39] The calculations were based on 2004 intrastate access revenue actually received and 2004 terminating and originating minutes of use for intrastate access services. Because the information is based on company-specific data, the identity of each of the carriers is not disclosed.

Colorado[40]

| Company | Scenario 1 - Originating $0.0 - Terminating 0.01 | Scenario 2 - Originating $0.01 - Terminating $0.01 | Scenario 3 - Originating $0.01 - Terminating $0.02 |
|---|---|---|---|
| 1 | $23.03 | $21.39 | $20.11 |
| 2 | 16.93 | 16.09 | 15.37 |
| 3 | 16.81 | 16.20 | 15.60 |
| 4 | 16.66 | 15.86 | 14.85 |
| 5 | 15.04 | 13.81 | 13.05 |
| 6 | 13.85 | 12.80 | 11.93 |
| 7 | 12.36 | 11.75 | 11.24 |
| 8 | 11.94 | 11.03 | 10.29 |
| 9 | 11.92 | 10.89 | 9.86 |
| 10 | 11.82 | 11.28 | 10.68 |
| 11 | 10.87 | 9.94 | 9.05 |
| 12 | 10.01 | 9.55 | 9.31 |
| 13 | 7.04 | 6.34 | 5.76 |
| 14 | 6.24 | 5.69 | 5.24 |
| 15 | 6.15 | 5.39 | 4.63 |
| 16 | 6.07 | 5.49 | 4.81 |
| 17 | 5.96 | 5.24 | 4.61 |
| 18 | 4.92 | 4.38 | 3.92 |
| 19 | 4.41 | 4.17 | 3.57 |

Oregon

| Company | Scenario 1 - Originating $0.0 - Terminating $0.01 | Scenario 2 - Originating $0.01 - Terminating $0.01 | Scenario 3 - Originating $0.01 - Terminating $0.02 |
|---|---|---|---|
| 1 | $15.58 | $13.75 | $12.34 |
| 2 | 12.98 | 11.41 | 10.31 |
| 3 | 12.51 | 11.12 | 9.86 |
| 4 | 12.32 | 10.80 | 9.80 |
| 5 | 11.57 | 10.64 | 8.90 |
| 6 | 10.75 | 9.54 | 8.48 |
| 7 | 10.73 | 9.59 | 8.43 |
| 8 | 8.33 | 7.46 | 6.53 |
| 9 | 8.02 | 7.21 | 6.27 |
| 10 | 7.75 | 6.90 | 6.10 |
| 11 | 7.62 | 6.98 | 6.14 |
| 12 | 7.16 | 6.19 | 5.76 |
| 13 | 6.34 | 5.50 | 5.09 |

[40] Some of the rural Colorado companies had incomplete data or were unable to respond in time to be included in this table.

| | | | |
|---|---|---|---|
| 14 | 6.26 | 5.52 | 4.96 |
| 15 | 6.21 | 5.56 | 4.87 |
| 16 | 5.76 | 5.10 | 4.56 |
| 17 | 5.60 | 4.99 | 4.41 |
| 18 | 5.04 | 4.40 | 4.02 |
| 19 | 4.89 | 4.37 | 3.83 |
| 20 | 4.87 | 4.33 | 3.83 |
| 21 | 4.73 | 4.30 | 3.67 |
| 22 | 3.92 | 3.41 | 3.13 |
| 23 | 3.64 | 3.18 | 2.91 |
| 24 | 3.51 | 3.07 | 2.80 |
| 25 | 2.68 | 2.33 | 2.14 |
| 26 | 2.60 | 2.32 | 2.04 |

Washington

| Company | Scenario 1 - Originating $0.0 - Terminating $0.01 | Scenario 2 - Originating $0.01 - Terminating $0.01 | Scenario 3 - Originating $0.01 - Terminating $0.02 |
|---|---|---|---|
| 1 | $60.05 | $59.01 | $56.97 |
| 2 | 40.37 | 38.80 | 37.32 |
| 3 | 35.21 | 32.07 | 30.41 |
| 4 | 30.37 | 28.25 | 27.42 |
| 5 | 27.63 | 27.01 | 26.62 |
| 6 | 26.38 | 24.34 | 23.33 |
| 7 | 26.15 | 25.14 | 24.30 |
| 8 | 25.98 | 25.16 | 24.25 |
| 9 | 23.90 | 23.44 | 22.48 |
| 10 | 23.19 | 22.52 | 21.80 |
| 11 | 21.01 | 14.73 | 9.20 |
| 12 | 20.19 | 19.18 | 18.50 |
| 13 | 16.12 | 15.50 | 15.03 |
| 14 | 14.07 | 13.22 | 12.58 |
| 15 | 13.18 | 12.50 | 11.52 |
| 16 | 13.15 | 12.41 | 11.52 |
| 17 | 11.46 | 10.89 | 10.21 |
| 18 | 11.14 | 10.44 | 9.98 |
| 19 | 8.97 | 8.32 | 7.72 |
| 20 | 8.18 | 7.70 | 6.39 |

These tables demonstrate that for many carriers, just on the intrastate access rates alone, moving to a unified carrier compensation regime could involve large shifts to end-users. Nor is this the case of adjusting below-average local rates. For many of these companies, they already have local rates above the national average for local end-user rates.

Shifting the amounts shown on the above tables to end-user SLCs would clearly violate §254 principles that comparable services be available in rural areas at comparable rates for the similar services offered in non-rural areas. Then, the question is whether universal service funding, federal or state, can accommodate these shifts. That calculation has not been completed as of this date. However, the amounts are not trivial. For the Washington companies listed in the table above, the amount is approximately 48 million dollars. Obviously, the calculation must be undertaken to determine what the effect would be on the continued growth, and resulting sustainability, of the universal service fund. There should be a careful balance of reducing access charges and increasing USF support.

3. <u>Cost Recovery Cannot Depend on Increasing End-User Charges</u>.

In the end, additional subscriber charges should be minimized. The ICF and NARUC proposals currently include increasing existing SLCs to $10 per month per residential line over time just to accommodate changes in interstate access rates. What the charts in Section V.2. demonstrate is that there is no more room to increase SLCs to cover the transition of intrastate access rates to a unified rate. For example, the company that has the least amount to transition in the state of Washington (Company 17 on the chart) already has local rates that exceed the nationwide average for RBOCs. Asking that company’s end-users to absorb another $6.00 to $8.00 per month in additional SLCs is not appropriate. Nor is it appropriate to expect the end-users of rural companies to pick up $10.00 per month, $20.00 per month or even more in the way of increased end-user charges to accommodate moving intrastate rates to a unified rate.

4. Cost Recovery Must Not be Predicated on the Theory that Rural Companies Can Absorb Revenue Losses.

There has been no showing to date that in high-cost areas, rural companies are earning overly generous rates of return. Absent delineation of any sort of windfall to rural companies, the amount of lost access revenue should be recovered by the rural companies. In order to continue the viability of rural networks, changes to intercarrier compensation should occur only with revenue offsets.

The existing revenue streams for rural companies are necessary to promote the growth and maintenance of rural networks. It is these rural networks that are key for rural broadband and other IP-type services. In rural areas, there is no such thing as a separate Internet network for VoIP traffic. The VoIP traffic must travel the rural telephone company's network. Until some date, long in the future, that reliable wireless broadband services are ubiquitously available, the rural telephone company networks form the very basis for the advancement of broadband and other type of IP services in rural areas. Thus, expecting rural companies to absorb the revenue loss from moving to a lower access rate does not work. Under that scenario, the incentive to invest in rural networks is destroyed.

As another observation, to the extent that the ICF plan with its bill and keep on originating traffic moves forward, consideration should be given to the effect on special access. Why would special access exist in the future if use of the originating network was without a charge and all that is paid for the use of the terminating network is a very low per-minute rate? Any calculation of the effect on end-users and the universal service fund should take into account what will happen with special access services.

## VI. UNIVERSAL SERVICE

1. It is not Wise Planning to Expect the Federal Universal Service Fund to Continue to Grow.

What must be recognized in this docket is that even at existing levels, the universal service fund is under increasing pressure. It may be a futile effort to try to force a higher level of the recovery of the costs that are incurred by rural telephone companies in operating, maintaining and building the rural PSTN into a universal service fund recovery mechanism. There are increasing questions about the sustainability of the universal service fund at existing rates.

The Rural Associations question whether the FCC can modify the universal service fund in ways that will further the political and financial acceptance of a growing fund. While the FCC has taken some beneficial steps towards making the ETC entry process meaningful in its March 17, 2005, ETC Designation Order,[41] those steps on their own cannot be expected to do much but slightly slow the pace of the growth in the universal service fund. The concept of pushing more and more cost recovery into a universal service fund has to be carefully examined.

A major theme in these Opening Comments is that a careful balance must be struck among the various cost recovery mechanisms. It is not appropriate to force end-users to absorb an inordinate share of the cost of the rural telephone company network. It is not appropriate that the universal service fund be used to pay for an inordinate share of the cost of the rural telephone company network. Nor, is it appropriate that other users, carriers, be forced to bear an inordinate share. However, it is not appropriate, in any sense, that other telecommunications carriers be given a free use of a rural telephone company network. All cost causers must bear a share of the cost of that network. It is a fallacy to say that the cost causer is the end-user who desires to call

[41] In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 05-46 (Rel. March 17, 2005).

outside of the rural network. The cost causer is the outside telecommunications carrier that desires to provide service to the customer that is within the rural telephone company service area. They derive the benefit, a clear financial benefit, from providing that service. It is only fitting that they bear a portion of that cost. Universal service funds are not the only answer. Universal service funds are part of the answer, not the complete answer. The complete answer is found in a balanced combination of intercarrier compensation, end-user rates and universal service funds.

2. Use of a Benchmark is Appropriate.

The Rural Associations support the use of a benchmark as a basis for calculating support from a universal service fund, assuming that there is an administratively simple procedure for companies to raise their rates to the benchmark. One possible benchmark is the RBOC national average for urban rates. This benchmark, which includes the SLC, is approximately $21.07 per month.[42] The Rural Associations support the use of this benchmark. A benchmark appears to be a necessary component to assure the states that provide support to the universal service fund on a "net contribution" basis that they are not supporting unreasonably low local rates in another state.

For those companies that need to increase local rates to reach the benchmark, the increase should be based upon a revenue neutral basis. This keeps the transactional costs associated with implementation of a new intercarrier compensation regime at an affordable level. If a particular state commission believes that a specific rural telephone company has an earnings problem, it has, as a general rule, the tools available to it to address that issue. There should not be a blanket requirement for a "showing" of movement to a benchmark on an earnings basis. That regulatory

[42] It should be noted that generally the RBOC rate also includes EAS calling. The comparable rural rate to measure against the benchmark is the local rate plus any EAS additive plus the SLC.

process increases the administrative costs of moving to a new program, costs which are borne by the rural customer.

3. <u>The Use of a "Block Grant" Program is Unworkable</u>.

Another concept that has been discussed in the context of universal service is the use of a "block grant"[43] type of approach.[44] Under this block grant approach, the current draws from the federal universal service fund would be calculated as a total on a state basis. This total would be awarded to the state commission for distribution. Under NARUC's approach, individual companies would be assured for only a relatively short period of time of receiving the same amount that they had received in the year prior to transition to the block grant approach. After that transitional period, then the state commissions would decide how to allocate the state "block grant" received from the federal universal service fund. The Rural Associations believe that this block grant approach is an idea that could easily backfire; leaving rural LECs uncertain about future investment decisions. Investment in rural telephone company networks could slow or even stop under a block grant approach. The block grant concept is also an idea that is contrary to law.

Under 47 U.S.C. §254(5), universal service support is to be "specific, predictable and sufficient." A support that is based upon a block grant approach with the states having the discretion to allocate those funds as they see fit cannot possibly be predictable. Nor could such a support mechanism reliably be "sufficient." Investment in telecommunications infrastructure in rural areas requires that the support mechanism be available over the life of the investment. How else can capital be raised from lending institutions? How could the government itself, through the Rural Utility Service, be assured that the amounts it lends to rural telephone companies can

[43] The term "block grant" is used by the Rural Associations as a shorthand description of the NARUC approach.
[44] <u>See</u>, NARUC's Ex Parte Presentation of March 1, 2005.

be repaid? The very nature of a block grant program that could shift funds on annual or short-term basis among companies hinders the availability of investment capital and the willingness to risk investment in high-cost areas.

4. The FCC May Not Rely on State USF Mechanisms to Develop a Unified Intercarrier Compensation Regime.

There is a suggestion that state USF mechanisms should be looked to to facilitate the development of a unified intercarrier compensation regime. However, the FCC may not rely on state USF mechanisms for two reasons. First, there are states in which no state USF mechanism exists. For example, in the state of Washington, the Washington commission is prohibited from creating a new USF fund without express legislative approval.[45] The Washington legislature has not granted such approval. The state of Washington is not alone in facing this dilemma. If states do not have existing universal service mechanisms in place, it is inappropriate for the FCC to make a decision relying on mechanisms that do not exist.

Further, the creation of a unified intercarrier compensation mechanism is an initiative of the FCC. The FCC should not create an "unfunded mandate." If the FCC creates an intercarrier compensation regime that explicitly or implicitly relies on shifting cost recovery from access charges to a state universal service fund, that constitutes an unfunded mandate. Further, such activity would clearly place the FCC in violation of the requirements set forth in 47 U.S.C. §254(b).

[45] RCW 80.36.610(1).

## VII. NETWORK INTERCONNECTION

The issues related to network interconnection potentially have important effects on rural telephone companies. If the Point of Interconnection (POI) is established as the access tandem, then this will impose significant additional costs[46] on rural telephone companies that they do not pay today, without any clear mechanism for how those costs would be recovered. The FCC should not impose additional costs on rural companies at the same time the FCC is looking to minimize existing compensation levels that rural telephone companies receive from carriers that use the rural telephone company's network.

Network interconnection rules should be structured to reflect the cost of the network. This means on the originating side, the rate cannot be set at zero or bill and keep. The carrier that uses the rural telephone company network for origination is imposing a cost and should pay its share.

Further, today there is a hole in many networks. That hole is at the tandem, whether the tandem is the local/EAS tandem or an access tandem. In Qwest's territory, Qwest takes the position that as the transit provider, it has no obligation to examine the origination of the traffic. Rather, its only obligation is to deliver the traffic for termination. This has allowed an exponential growth in Phantom Traffic, where traffic is delivered over an EAS network or a Feature Group C network without associated records provided so that the originating carrier can be billed for the termination of that traffic. The Commission's network and interconnection rules must address the transit provider issue.

For many rural telephone companies, there are no alternative choices for tandem providers. This means the tandem providers exhibit market power. Witness the Qwest position

[46] Today, for most rural companies, the POI is at the exchange boundary or at the rural telephone company's switch.

on delivery of traffic described earlier. Current events show increasing consolidation of vertically integrated providers: the SBC/AT&T merger and the apparent Verizon/MCI merger. The potential for the transit/tandem provider to have market power over rural telephone companies is very high. Under these circumstances, the duties of the transit provider should be clearly established and the rates charged for that service subject to regulatory review.

## VIII. TECHNOLOGICAL NEUTRALITY

It is time for the FCC to put to rest the concept that any provider of telecommunications or, if you like, telecommunications-like, services should not pay for their use of the PSTN. Any provider that uses the PSTN should pay their appropriate share of the costs of that network. This includes VoIP or any other technology that is involved. The FCC should not promote arbitrage in the name of assisting a "nascent" technology. The FCC should not promote arbitrage through "laissez-faire" regulation.

# IX. IMPLEMENTATION ISSUES

1. Pooling is an Important Mechanism for Rural Telephone Companies.

The FCC asked a question about whether pooling should be allowed.[47] Pooling is an appropriate mechanism for rural carriers. It adds administrative efficiencies and risk management benefits that rural telephone companies would not be able to achieve by individual company action. By having a pool with a single administrator, the costs of administration of a compensation regime can be minimized for rural carriers. The administrative burdens are reduced through pooling by not having to maintain individual tariffs of the complexity that would otherwise be required.

With pooling, reducing risk occurs by stabilizing cash flows and offsetting the effect of unexpected demand reductions or increased costs. This risk reduction aspect of pooling makes investment in rural ILEC infrastructure more appealing to lenders by providing at least some limited assurance of adequate cost recovery.

2. Use of a Collaborative Federal-State Process will Benefit Implementation.

Another implementation issue is the development of mechanisms for state involvement. Implementation of any new intercarrier compensation regime should continue to allow the states to play a significant role, particularly in consumer protection and quality of service. In addition, there should be a collaborative process to explore the costs of any plan that is proposed and what that might mean in terms of end-user rates and effect on any state universal service fund.[48] In short, use of a collaborative federal-state mechanism will benefit implementation of a unified intercarrier compensation regime.

[47] FNPRM at ¶116.
[48] It should not be assumed that each state has the authority to adopt a state universal service fund at the present time. For example, the state of Washington has a statute which prohibits the state commission from establishing a new universal service program. RCW 80.36.610(1).

## CONCLUSION

The Rural Associations urge the FCC to exercise extreme caution in evaluating all of the plans that are before it on the subject of creating a unified intercarrier compensation regime. The Rural Associations' position is that there must be a balanced approach. The balanced approach has three elements. The first element relies on reasonable carrier charges for an outside carrier's use of a rural telephone company's network for the outside carrier to provide service to its customers. The second part of the balanced approach is reasonable end-user charges. These reasonable end-user charges must adhere to the principle in 47 U.S.C. §254(b) that rates for services in rural areas must be comparable to rates for similar services in urban areas. The third part of a balanced approach is a reasonable universal service fund. The federal universal service fund cannot be expected to continue to grow at the rate it is growing today. Forcing cost recovery out of intercarrier charges and into a federal universal service fund may not be politically sustainable. Nor may the Commission rely upon the state universal service funds to pick up the difference. In some states, such funds do not exist. In many states, there are already questions about the sustainability of the intrastate universal service funds.

The task before the Commission is difficult. However, bill and keep has not been shown to be appropriate today. It is not appropriate for tomorrow. A balanced approach is the only reasonable solution to maintain investment in rural networks and the continued ability of rural telephone companies to provide basic and advanced services for rural America.

Respectfully submitted this 23rd day of May, 2005.

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